

Message Text

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C O N F I D E N T I A L ROME 20669

LIMDIS GREENBACK

TREASURY FOR SYVRUD

E.O. 11652: GDS

TAGS: EFIN, IT

SUBJ: ITALY; BALANCE OF PAYMENTS DEVELOPMENTS AND IMF
RELATIONS

REF: STATE 294485

1. SUMMARY. BANK OF ITALY DIRECTOR GENERAL ERCOLANI
FORSEES ITALY SCRAPPING THE PRESENT STANDBY AGREEMENT
WITH THE IMF AND RENEGOTIATING A NEW ONE FOR BOTH 1978
AND 1979. ERCOLANI PROJECTED THAT AN ENLARGED PUBLIC
SECTOR DEFICIT ON THE ORDER OF 24,000 BILLION LIRE FOR
1978 IS CONSISTENT WITH A CURRENT ACCOUNT SURPLUS IN THE
BALANCE OF PAYMENTS, BUT WITH THE SURPLUS DECREASING DURING
THE COURSE OF THE YEAR. HE DID NOT EXPECT ANY DIFFICULTY
IN MEETING THE DEBT REPAYMENTS DUE IN 1978. WITH RESPECT
TO ITALY'S EXCHANGE RATE POLICY, HE NOTED THA THE LIRA
WOULD MORE OR LESS CONTINUE TO FOLLOW THE DOLLAR AND SAID
THAT ITALY HAS LIVED VERY COMFORABLY WITH THE RECENT
DEPRECIATION OF THE U.S. CURRENCY. HE NOTED THAT THE
ANDREOTTI GOVERNMENT HAS BEEN MADE INEFFECTIVE BY THE
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OTHER PARTIES AND THE UNIONS AND IS ON THE VERGE OF
FALLING. END SUMMARY.

2. TREASURY AND ASSISTANT TREASURY ATTACHES TOOK OCCASION
OF CALL ON BANK OF ITALY DIRECTOR GENERAL ERCOLANI FOR
PURPOSE OF CLARIFYING U.S. OBJECTIVES WITH RESPECT TO
ONGOING BILATERAL DISCUSSIONS WITH THE JAPANESE (AS PER

REFTEL) TO SEEK ERCOLANI'S VIEWS ON THE FOLLOWING SUBJECTS: ITALY-IMF RELATIONS, BALANCE OF PAYMENTS OUTLOOK, 1978 DEBT REPAYMENTS, AND ITALIAN EXCHANGE MARKET STRATEGY. ERCOLANI ALSO VOLUNTEERED VIEWS ON LONGEVITY OF CURRENT GOVERNMENT.

3. ITALY-IMF RELATIONS. ERCOLANI BELIEVED THAT ITALY WOULD MOST LIKELY NEGOTIATE A COMPLETELY NEW STANDBY WITH THE FUND INSTEAD OF TRYING TO RENEGOTIATE THE TARGETS OF THE PRESENT AGREEMENT. HE THOUGH A NEW STANDBY SHOULD COVER THE YEARS 1978 AND 1979 AND THE AMOUNT SHOULD BE INCREASED TO \$1.0 BILLION. ERCOLANI SAID ITALY DOES NOT PLAN TO MAKE THE DRAWING SCHEDULED FOR DECEMBER UNDER THE EXISTING STANDBY ON THE GROUNDS THAT THE PRESENT LEVEL OF RESERVES DOES NOT REQUIRE IT. THE DIRECTOR GENERAL DEFENDED ITALY'S PERFORMANCE DURING 1977 UNDER THE STANDBY BY POINTING TO THE BETTER-THAN-EXPECTED OUTCOME ON INFLATION AND BALANCE OF PAYMENTS AND THE SATISFACTORY BEHAVIOR OF DOMESTIC CREDIT EXPANSION. HE ACKNOWLEDGED THAT HE ENLARGED PUBLIC SECTOR DEFICIT WAS THE ONE MAJOR AND IMPORTANT AREA IN WHICH ITALY HAD FAILED TO LIVE UP TO EXPECTATIONS. HE PREDICTED THAT THE 1977 TARGET OF 16,450 BILLION LIRE WOULD BE EXCEEDED BY ABOUT 3,000 BILLION LIRE (HE MENTIONED A TOTAL DEFICIT OF CLOSE TO 20,000 BILLION LIRE IN 1977). EH SAID THE 14,450 FIGURE AGREED TO IN THE STANDBY FOR CONFIDENTIAL

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1978 WAS UNREALISTICALLY LOW AND HAD BEEN ARRIVED AT IN A VERY "UNSCIENTIFIC" WAY. WHILE HE PERSONALLY WAS UNHAPPY WITH THE OUTLOOK FOR THE DEFICIT FOR NEXT YEAR-- PARTICULARLY ABOUT THE INCREASE IN CONSUMPTION-TYPE EXPENDITURES --HE CLAIMED THAT ITALY IN 1978 WILL HAVE TO BE ITS OWN LOCOMOTIVE. GIVEN THE DEPRESSED STATE OF INVESTMENT DEMAND, THE PUBLIC SECTOR WILL HAVE TO CONTINUE TO PLAY AN "ACTIVE" ROLE.

4. BALANCE OF PAYMENTS OUTLOOK. ERCOLANI STATED THAT AN ENLARGED DEFICIT OF 24,000 BILLION LIRE IN 1978 IS CONSISTENT WITH A CURRENT ACCOUNT SURPLUS FOR THE YEAR AS A WHOLE BUT WITH THE SIZE OF THE SURPLUS NARROWING AS THE YEAR PROGRESSED. THIS IS WHY HE THOUGHT THAT A NEW STANDBY WOULD HAVE TO COVER BOTH 1978 AND 1979, THE IMPLICATION BEING THAT IN 1979 THE BALANCE OF PAYMENTS COULD BE A PROBLEM. SINCE THE FISCAL STANCE OF THE GOVERNMENT WAS NOT QUITE DECIDED YET, HE SAID THE BANK HAD NOT DONE A "FINAL" FORECAST FOR NEXT YEAR. HOWEVER, HE WOULD ACCEPT A TENTATIVE CURRENT ACCOUNT SURPLUS OF "ABOUT \$1.0 BILLION."

5. 1978 DEBT REPAYMENTS. REGARDING 1978 DEBT REPAYMENTS DUE THE EC AND BUNDESBANK (\$1,400 MILLION AND \$1,500 MILLION, RESPECTIVELY), ERCOLANI THOUGHT THAT, SHOULD IT SO DESIRE, ITALY WILL BE ABLE TO ROLL-OVER OR STRETCH OUT THESE REPAYMENTS. HE DID NOT FORESEE PAYMENTS DUE TO THE IMF AND TO PRIVATE LENDERS AS POSING ANY DIFFICULTY.

6. EXCHANGE MARKET DEVELOPMENTS. ERCOLANI SAID THAT ITALY HAS BEEN ABLE TO LIVE VERY COMFORTABLY WITH THE RECENT WEAKNESS OF THE DOLLAR. SINCE 40 PERCENT OF ITS IMPORTS AND 20 PERCENT OF ITS EXPORTS ARE DENOMINATED IN DOLLARS, THE DEPRECIATION OF THE DOLLAR HAS ALLOWED ITALY'S TERMS OF TRADE TO IMPROVE. WITH RESPECT TO THE BANK OF ITALY'S INTERVENTION POLICY, ERCOLANI NOTED THAT CONFIDENTIAL

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THE LIRA WOULD MORE OR LESS CONTINUE TO FOLLOW THE U.S. DOLLAR. HE EXPRESSED SURPRISE, HOWEVER, THAT THE UNITED STATES WOULD LET THE DOLLAR DEPRECIATE THE WAY IT HAS. HE SAID HE DOES NOT SHARE THE VIEW OF OTHERS WHO PRESCRIBE HIGHER INTEREST RATES AS A SOLUTION TO THE PROBLEM. HE WOULD, INSTEAD, LIKE TO SEE THE U.S. INTERVENE IN THE MARKET BY ACTIVATING THE FED SWAP SYSTEM AND, IF NECESSARY, BY BORROWING LONG-TERM SUCH STRONG CURRENCIES AS THE DEUTSCHEMARK.

7. FATE OF ANDREOTTI GOVERNMENT. ERCOLANI EXPRESSED CONSIDERABLE PESSIMISM ABOUT THE LONGEVITY OF THE ANDREOTTI GOVERNMENT, SAYING THAT THE BEHAVIOR OF THE OTHER POLITICAL PARTIES AND THAT OF THE LABOR UNIONS, WITH RESPECT TO BOTH ECONOMIC AND POLITICAL ISSUES, HAVE IN EFFECT PULLED THE RUG FROM UNDER THE GOVERNMENT. HE VOLUNTEERED THAT STAMMATI HAD LITTLE SUPPORT WITHIN THE GOVERNMENT (EXCEPT FOR BAFFI) FOR HIS HARD-LINE POSITION ON THE NEED TO REDUCE PUBLIC EXPENDITURES. (IN AN EARLIER MEETING WITH TREASURY DIRECTOR GENERAL PALUMBO, TREASURY ATTACHE WAS TOLD THAT IN ANY CABINET SHAKE-UP OR CHANGE IN GOVERNMENT, TREASURY MINISTER STAMMATI WOULD PROBABLY HAVE TO GO.) GARDNER

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